

Contemporary Issues in International Arbitration and Mediation

The Fordham Papers 2013

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PART 4

Investor-State Arbitration (2)



The Objections of Developed and Developing States to Investor-State Dispute Settlement, and What They Are Doing about Them

O. Thomas Johnson and Catherine H. Gibson

Introduction

On April 12, 2011, the Australian government announced that it would no longer seek to include investor-state dispute settlement (“ISDS”) procedures in investment treaties with developing countries,¹ having never entered into a treaty with a developed country that contained such a provision.² Australia’s 2011 policy change is one recent and, because it comes from a developed

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1 Aust. Gov’t, Dep’t of Foreign Aff. & Trade, Gillard Government Trade Policy Statement: Trading Our Way to More Jobs and Prosperity 14 (Apr. 2011), <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html>.

2 Australia’s free trade agreement with the United States, for example, does not contain an investor-state dispute-settlement procedure. *See* Australia-United States Free Trade Agreement, May 18, 2004, 118 Stat. 919, available at http://www.ustr.gov/sites/default/files/uploads/agreements/fta/australia/asset_upload_file148_5168.pdf. Instead, that agreement permits “consultations on investor-state dispute settlement” “[i]f a party considers that there has been a change in circumstances affecting the settlement of disputes . . . and that, in light of such change, the Parties should consider allowing an investor of a Party to submit to arbitration with the other party a claim.” *Id.* art. 11.16. Australia and New Zealand followed this policy when they excluded disputes as between themselves from the dispute-resolution mechanism of the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA). *See* New Zealand-Australia Agreement on Application of AANZFTA, available at <http://www.asean.fta.govt.nz/assets/Downloads/Instruments/AANZFTA-CER-application-letter-Signature-Text.pdf> (stating that that the AANZFTA dispute-settlement provisions “shall not create any rights or obligations between New Zealand and Australia”); *see also* Australian Government Productivity Commission Research Report, *Bilateral and Regional Trade Agreements* at 266, (November 2010), http://www.pc.gov.au/_data/assets/pdf_file/0010/104203/trade-agreements-report.pdf (indicating that Australia has declined to include ISDS in arbitration agreements “where Australia and the partner country operate stable and well-functioning legal systems”) [hereinafter *Productivity Commission Report*].

country, perhaps the most striking example in a series of actions taken by both developed and developing states to modify their future practice with respect to investment treaties and, in some cases, to modify their existing treaty commitments. (Australia reversed course late last year when a new government came into power and now considers ISDS on a “case-by-case” basis.)³ This paper examines the actions of both developing and developed countries and suggests that, for the most part, these actions have been more appropriate responses to the underlying concerns of the states involved than at first may appear. Because they in fact have little in common, this paper examines the concerns of developing and developed countries separately.

I *The Concerns and Actions of Developing Countries*

A few developing countries appear to be in the process of leaving the regime of bilateral investment treaties (“BITs”)⁴ entirely. For example, Venezuela gave notice in 2008 that it was terminating its BIT with The Netherlands⁵ and in 2012 announced its withdrawal from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“the ICSID Convention”).⁶ Bolivia withdrew from the ICSID Convention in 2007⁷ and has stated that it intends to renegotiate several BITs, particularly their dispute-res-

3 See Minister for Foreign Affairs, The Hon. Julie Bishop, Address to AustCham Business Breakfast, 18 October 2013, http://www.foreignminister.gov.au/speeches/2013/jb_sp_131018.html; Australian Government, Department of Foreign Affairs and Trade, Frequently Asked Questions on Investor-State Dispute Settlement, <https://www.dfat.gov.au/fta/isds-faq.html>.

4 Investment treaties are most commonly bilateral, but they also may be multilateral. Their key elements are obligations assumed by each State Party with respect to the treatment of investments in its territory of nationals of the other State Parties, and the consent by each State Party to arbitrate disputes between itself and investors of the other State Parties concerning that State's compliance with its obligations under the treaty. Often these obligations and consents are contained in a part of a broader agreement that addresses trade and other issues in addition to foreign investment, such as the North American Free Trade Agreement (“NAFTA”). The acronym “BIT” sometimes will be used to refer to all types of investment treaties.

5 See Luke Eric Peterson, *Venezuela Surprises the Netherlands with Termination Notice for BIT*, 1 Investment Arb. Rep., May 16, 2008, http://www.iareporter.com/downloads/20100107_27.

6 Venezuela Submits a Notice Under Article 71 of the ICSID Convention, ICSID (Jan. 26, 2012), <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement100>.

7 Bolivia Submits a Notice under Article 71 of the ICSID Convention, (May 16, 2007), <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Announcement3>.

olution clauses, after a change to its constitution subjected all foreign investment to “Bolivian jurisdiction, laws, and authorities.”⁸ Ecuador gave notice in 2007 that it would not recognize ICSID tribunals’ jurisdiction over disputes concerning certain natural resources,⁹ terminated nine BITs in 2008,¹⁰ and then withdrew from the ICSID Convention altogether in 2009.¹¹ In addition, the Ecuadorian constitution now prohibits the government from entering into agreements that transfer jurisdiction over the state’s contractual or commercial disputes to international arbitral bodies, and the Ecuadorian government has taken steps toward withdrawing from agreements that would violate this provision.¹² Venezuela, Bolivia, and Ecuador have each distanced themselves from the BIT and ISDS regime after actions were taken to nationalize (or re-nationalize) specific industries.¹³

Other developing countries have raised concerns about the BIT and ISDS regime after large arbitral awards were issued against them, but these countries have not indicated any intention to leave the BIT and ISDS system. Argentina, for example, remains in the BIT and ISDS system, despite the many hundreds of millions of dollars in awards already rendered against it, and the 34 pending cases in which it is a respondent.¹⁴

8 U.S. Department of State, 2012 Investment Climate Statement—Bolivia (June 2012) (quoting relevant provision of Bolivian constitution, which states “[e]very foreign investment will be subject to Bolivian jurisdiction, laws, and authorities, and no one may invoke a situation for exception nor appeal to diplomatic claims to obtain more favorable treatment”), <http://www.state.gov/e/eb/rls/othr/ics/2012/191112.htm>.

9 Ecuador’s Notification under Article 25(4) of the ICSID Convention, <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement9>.

10 UNCTAD, IIA Issues Note No. 2, Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims (December 2010), at 1 n.3, available at http://unctad.org/en/Docs/webdiaeia20106_en.pdf.

11 Ecuador Submits a Notice under Article 71 of the ICSID Convention (July 9, 2009), <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Announcement20>.

12 2009 UNCTAD World Investment Report at 32 and n.49, http://unctad.org/en/docs/wir2009_en.pdf; see also U.S. Trade Representative 2012 National Trade Estimate Report on Foreign Trade Barriers at 127–28, <http://www.ustr.gov/about-us/press-office/reports-and-publications/2012-1>.

13 For details on the events in each country see Diana Marie Wick, *The Counter-Productivity of ICSID Denunciation and Proposals For Change*, 11 J. INT’L BUS. & L. 239, 241–49 (2012).

14 See United Nations Conference on Trade and Development, Database of Treaty-Based Investor-State Dispute Settlement Cases, <http://iadbcases.unctad.org/index.html>.

In the early 1990s, Argentina went through an ambitious privatization program aimed at attracting foreign investment in its public-utilities sector. It pegged its currency to the U.S. dollar and passed laws setting public-utility tariffs in U.S. dollars, with semi-annual adjustments based on the U.S. Producer Price Index.¹⁵ Public-utility companies that were to be privatized were issued licenses that implemented these laws and obligated the government to compensate licensees for any losses suffered as a result of changes to the above-described tariff system. U.S. and other foreign investors bought shares in these licenses and invested in needed infrastructure.¹⁶ After the financial crisis of the late 1990s, Argentina undid these laws,¹⁷ and foreign-owned licensees lost large sums of money. American investors sought arbitration under the 1991 U.S.-Argentina BIT and alleged, among other claims, that the steps taken by Argentina's congress violated the BIT's prohibition against uncompensated expropriation and its guarantee of fair and equitable treatment.¹⁸ Although these challenges were presented pursuant to investor-state dispute settlement and based entirely on the U.S.-Argentina BIT, the core cause of these proceedings was Argentina's internal laws, not the existence of an investment treaty.

By far the most serious difficulty caused by Argentina's financial crisis—at least as it affected foreign investors—had nothing to do with the public-utility sector and the related ICSID cases; Argentina's real problem with the outside

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- 15 See *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, ¶¶36–42, 49–50 & 119–120 (Oct. 3, 2006) [hereinafter *LG&E Award*]; *CMS Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, ¶¶53–57, 134–138, & 139–144 (May 12, 2005) [hereinafter *CMS Award*]; *Enron Corp., Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, ¶¶41–46 (May 22, 2007) [hereinafter *Enron Award*]; *Sempra Energy Int'l v. Argentine Republic*, Case No. ARB/02/16, Award, ¶¶82–84 (Sept. 28, 2007) [hereinafter *Sempra Award*].
- 16 *LG&E Award*, *supra* note 15, at ¶¶34–53; *CMS Award*, *supra* note 15, at ¶¶57, 135–38, 160–162; *Enron Award*, *supra* note 15, at ¶¶43–44; *Sempra Award*, *supra* note 15, at ¶¶84–86.
- 17 *LG&E Award*, *supra* note 15, at ¶¶64–68 & 120. The Argentine government initially sought to remedy the situation with provisional measures. The government and the licensees agreed to postpone the adjustment scheduled for January 2000. *LG&E Award*, *supra* note 15, at ¶58. The Argentine government and the licensees thereafter agreed to a second postponement of the tariff with the establishment of a fund so that licensees could recoup the postponed amounts, but this agreement was subsequently enjoined. *LG&E Award*, *supra* note 15, at ¶¶60–62. These provisional measures were ultimately ineffective.
- 18 *LG&E Award*, *supra* note 15, at ¶72; *CMS Award*, *supra* note 15, at ¶88; *Sempra Award*, *supra* note 15, at ¶¶94–95; *Enron Award*, *supra* note 15, at ¶89.

world was with the holders of the \$150 billion in bonds on which it defaulted.¹⁹ By 2010 two successful bond-exchange programs had effectively rescheduled all but about \$6 billion of this debt. Holdout creditors filed suits in the courts of the United States, Germany, and Italy, seeking to collect on bonds governed by the national laws of these and other countries and denominated in various foreign currencies. One case that began in federal court in New York, for example (and in which the bond holders thus far are prevailing), was based on a bond that was governed by New York law and provided for jurisdiction in “any state or federal court in The City of New York.”²⁰ Argentina’s legal problems with its foreign bond holders thus had nothing to do with the terms of any investment treaty and everything to do with the terms of the bonds themselves. To a great extent, the same can be said of the much less significant disputes between Argentina and foreign investors in its public-utility sector; BITs provided a forum, but it was the deals struck with foreign investors that were the core of the problem. This point is further demonstrated by earlier events in Indonesia.

Like Argentina, Indonesia also faced a series of arbitrations following emergency measures taken in response to a financial crisis, but in Indonesia’s case, the arbitrations were based on contracts between Indonesian state-owned entities and foreign investors, and were entirely outside the investment-treaty system. In the early 1990s, Indonesia contracted with foreign investors to harness its geothermal energy sources and agreed to make certain payments in U.S. dollars.²¹ The Indonesian rupiah collapsed in 1997,²² and the Indonesian government issued a presidential decree suspending, continuing, or delaying the projects planned in these contracts.²³ When investors proceeded to

19 See Michael Waibel, SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS 15–16 (2011).

20 *NML Capital, Ltd. v. Argentina*, 699 F.3d 246, 254 (2d Cir. 2012). The Second Circuit’s most recent decision in the case is *NML Capital, Ltd. v. Argentina*, 727 F.3d 230 (2d Cir. 2013). The much-discussed *Abaclat* case is an example of a BIT providing an additional remedy in that the Italian bondholders in that case, like the bondholders in *NML Capital*, could have brought suit in municipal courts outside Argentina. See *Abaclat and Others v. Argentina*, ICSID Case No. ARB/07/05, Decision on Jurisdiction and Admissibility, 4 August 2011, at ¶¶82–91.

21 *Patuah Power Ltd. (Bermuda) v. PT. PT (Persero) Perusahaan Listrik Negara*, 14 MEALEY’S INT’L ARB. REP. B-14 (1999), ¶¶6–17 [hereinafter Patuah Power Award]; *Himpurnia California Energy Ltd. (Bermuda) v. PT (Persero) Perusahaan Listrik Negara (Indonesia)*, 14 MEALEY’S INT’L ARB. REP. B-14 (1999), ¶¶6–17 [hereinafter Cal Energy Award].

22 Patuah Power Award, *supra* note 21, at ¶24.

23 Patuah Power Award, *supra* note 21, at ¶¶24–28; Cal Energy Award, *supra* note 21, at ¶¶24–28.

arbitration under their contracts, the tribunals enforced the contracts according to their terms and issued very large awards against Indonesia.²⁴

As noted above, neither Indonesia nor Argentina threatened to leave the BIT regime in response to the arbitral decisions that have gone against them, at least not immediately.²⁵ Indonesia concluded multiple BITs after its financial crisis²⁶ and passed legislation to ease the enforcement of arbitral awards in domestic courts.²⁷ Argentina has argued within the existing investment treaty system to defend its actions and to challenge arbitral awards against it. In the public-utilities cases, Argentina attempted to rely on the customary international law defense of necessity and also argued that the non-precluded measures clause of the U.S.-Argentina BIT—which permits the host state to apply “measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests”²⁸—was a self-judging provision that permitted Argentina to take the challenged actions

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- 24 Indonesian state-owned companies were ordered to pay over \$391 million for sunk costs and expected profits in the Cal Energy Final Award, *supra* note 21, at ¶596. Other cases yielded similar results. See *Karaha Bodas Company v. Perusahaan Pertambangan Minyak dan Gas Bumi Negara*, Final Award (Dec. 18, 2000), 16 MEALEY’S INT’L ARB. REP. C-2-C17 (2001), ¶¶54–56 (finding breach of contract and awarding \$260 million (plus interest) against State-owned entities for investors’ lost expenditures and lost profits); *Patuah Power* Final Award, *supra* note 21, at ¶503 (finding breach of contract and ordering the State-owned entity to pay investors over \$180 million in damages and costs of arbitration).
- 25 On March 13, 2014, Indonesia notified the Netherlands of its decision to terminate not only the Indonesian-Dutch BIT, but also all 67 of Indonesia’s BITs. See Netherlands Embassy in Jakarta, Indonesia, News article dated March 13, 2014, <http://indonesia.nlembassy.org/news/2014/03/bilateral-investment-treaty%5B2%5D.html>.
- 26 ICSID Database of Bilateral Investment Treaties, <https://icsid.worldbank.org/ICSID/FrontServlet>. This database indicates that Indonesia has signed bilateral investment treaties with Saudi Arabia, Germany, Croatia, Algeria, Chile, and India since 1998.
- 27 In August 1999, Indonesia enacted Law No. 30/1999 Concerning Arbitration and Alternative Dispute Resolution, a provision that commentators have characterized as “imperfect” but “in favor of arbitration.” J.K. Schaefer and Mulyana, *Indonesia’s New Framework for International Arbitration: A Critical Assessment of the Law and its Application by the Courts*, *International Arbitration Quarterly Law Review*, volume 2 issue 3 at 90 (June 2005). More recent commentators have stated that, despite previous difficulties with enforcement, “some reports suggest that Law No. 30/1999 has resulted in overall improvements and greater expedition, in particular in relation to enforcement of foreign awards.” Kate Davies, *To 2027 and Beyond: A Survey of Arbitration in the ‘Asian Century’*, *Transnational Dispute Management*, volume 8 issue 5 at 21–27 (December 2011).
- 28 Treaty Between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, art. IX, U.S.-Argentina, November 14, 1991, 31 I.L.M. 124.

to address its financial crisis. After three arbitral panels rejected Argentina's arguments,²⁹ Argentina sought review of these decisions through the ICSID annulment process and obtained some success in lowering the awards against it.³⁰ Argentina also unsuccessfully sought a United States declaration that the non-precluded-measures clause in the U.S.-Argentina BIT was intended to be self-judging.³¹ Apparently seeing wisdom in Argentina's point, if not agreeing with it as a matter of treaty construction, the 2004 U.S. Model BIT explicitly makes its provision on non-precluded measures self-judging.³²

29 The CMS, Enron, and Sempra panel decisions largely rejected Argentina's arguments, while the LG&E panel agreed with Argentina in part, stating that "[b]etween 1 December 2001 and 26 April 2003, Argentina was in a state of necessity, for which reason it shall be exempted from the payment of compensation for damages incurred during that period." CMS Award, *supra* note 15, at ¶267.d.

30 The Enron annulment committee annulled the panel's "finding... and associated reasoning" that Argentina could not rely on the non-precluded measures provision of the U.S.-Argentina BIT and the customary international law principle of necessity, and it annulled \$106.2 million of the award against Argentina. *Enron Creditors Recovery Corp. v. Argentina*, ICSID Case No. ARB/01/3, Decision on the Application for Annulment of the Argentine Republic, ¶169 (Jul. 30, 2010). The Sempra annulment committee annulled the panel's award "on the ground of manifest excess of powers... owing to the failure of the Arbitral Tribunal to apply [the non-precluded measures clause]" and "such annulment applie[d] to the award in its entirety." *Sempra Energy Int'l v. Argentina*, ICSID Case No. ARB/02/16, Decision on the Argentine Republic's Request for Annulment of the Award, ¶229 (Jun. 29, 2010). The CMS annulment committee stated that the panel committed a "manifest error of law" in its analysis of the non-precluded measures provision of the U.S.-Argentina BIT but declined to annul the award on that basis. *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Decision of the *ad hoc* Committee on the Application for Annulment of the Argentine Republic, ¶¶130 & 146 (Sept. 25, 2007).

31 Shane Romig, *Argentina Seeks Diplomatic Exit from ICSID Suits*, Dow Jones, Oct. 12, 2007, available at <http://www.bilaterals.org/spip.php?article9950>. See also William W. Burke-White, *The Argentine Financial Crisis*, in *THE BACKLASH AGAINST INVESTMENT ARBITRATION* 407, 431 (Michael Waibel et al., eds. 2010). Burke-White acted as an expert for Argentina in the underlying arbitrations.

32 That clause states that "[n]othing in this Treaty shall be construed... to preclude a Party from applying measures that *it considers* necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests." See 2004 U.S. Model Bilateral Investment Treaty, art. 18, available at <http://www.state.gov/documents/organization/117601.pdf> (emphasis added) [hereinafter 2004 U.S. Model BIT]. One commentator postulates that this change to the 2004 U.S. Model BIT, along with others, demonstrates a loss of confidence in the Washington Consensus. Jose E. Alvarez, *Why are we "Re-Calibrating" Our Investment Treaties?* *World Arbitration & Mediation Review*, Vol. 4. No. 2, at 143, 143–45 (2010).

Argentina has remained in the investment treaty system, as had Indonesia until very recently, because their concerns differ from those of Venezuela, Ecuador and Bolivia. To oversimplify only somewhat, the problems of Argentina and Indonesia arose from the combined effects of imprudent inducements to foreign investors—embodied in laws, contracts (particularly bonds) and licenses that amounted to contracts—and catastrophic financial crises. Treaty commitments were not the source of the problem; indeed, they were completely irrelevant in the case of Indonesia, and in Argentina’s bond disputes have very largely been dealt with in municipal courts outside Argentina without reference to a BIT. The concerns of Venezuela, Ecuador and Bolivia, on the other hand, arise from a desire to nationalize property without paying for it.

II *The Concerns and Actions of Developed Countries*

Developed countries—or at least some elements within developed countries—largely raise the same concerns about BITs. These concerns are fairly summarized in the lengthy report of Australia’s Productivity Commission that formed the basis of Australia’s new policy.³³ The principal concern expressed by developed countries relates to two provisions commonly found in BITs: one requiring that foreign investors be compensated if their investment is expropriated indirectly—that is, as a result of government action other than an explicit taking, and another requiring that foreign investors and their investments be accorded “fair and equitable treatment.” The concern is that the obligations imposed by these provisions are unclear and thus may result in arbitral decisions that interfere with government action that is aimed solely at the protection of health, the environment, or other aspects of public welfare.³⁴ The Productivity Commission Report summarized the foundation of this concern nicely: “In some circumstances, otherwise routine actions of government have been held to breach specific rights granted to foreign investors under a [BIT].”³⁵

33 Productivity Commission Report, *supra* note 2, at 265–77.

34 *Id.* at 267–68. The Report lists other common objections to the compulsory investor-state dispute-resolution process: *e.g.*, that the process has a pro-investor bias because only investors can bring claims, that conflicts of interest arise as a result of the same persons serving as arbitrators and as counsel in different cases, that rulings of different panels on the same or similar issues are inconsistent, that there is insufficient transparency, and that the process is so costly that it burdens some states and ensures that “only the largest investors can afford” to bring claims. *Id.* at 271–74.

35 *Id.* at 267.

Interestingly, every example of such a holding cited in the report was a NAFTA case.³⁶ Acknowledging that, at the time of its publication, no foreign investor had ever brought a case against Australia under any of its investment agreements, the Report goes on to discuss what it calls “regulatory chill,” which occurs as a result of the possibility, rather than the actuality, of an arbitral decision that finds fault with ordinary regulatory action:

ISDS provisions can further restrict a government’s ability to undertake welfare-enhancing reforms at a later date, a problem known as ‘regulatory chill’. Such ‘chilling’ occurs because [of] the investment clauses that provide protection against ‘indirect expropriation’ and ‘fair and equitable treatment’... These protections and minimum standards of treatment are extended to foreign investors but often not afforded to domestic investors, and can involve such government actions as changes to environmental legislation, taxation arrangements or licencing schemes. ‘Chilling’ occurs when governments choose not to undertake regulatory action (as opposed to directly expropriating property) for fear of triggering arbitration claims or paying compensation.³⁷

Australia is not the first or only nation with concerns about regulatory chill. Similar concerns were partly responsible for the abandonment of Norway’s

36 The three NAFTA cases cited in Australia’s Productivity Commission Report, *Ethyl, Metalclad*, and *Pope & Talbot*, *id.* at 271, do not actually support the notion that “otherwise routine government actions have been held to breach specific rights granted to foreign investors.” The Canadian measure in *Pope & Talbot* was not related to public welfare, but rather the relative distribution of lumber quotas. *Pope & Talbot v. Canada*, UNCITRAL (NAFTA), Final Merits Award, ¶¶18–29 (April 10, 2001). Moreover, the only NAFTA violation found in the Final Award was based on retaliatory measures taken by the Canadian government after they were notified that the claimant would initiate the arbitration. *Id.* at ¶¶194–95. The *Ethyl* case did involve a challenge to an environmental measure, Canada’s ban on a fuel additive, but the case was settled after the ban was struck down in a non-NAFTA proceeding initiated by Canadian provinces. Foreign Affairs, Trade, and Development Canada, *Ethyl Corporation v. the Government of Canada*, <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/ethyl.aspx?lang=eng>. Finally, the government action in *Metalclad*—a Mexican town’s attempt to block waste management operations already approved by Mexico’s federal government—was hardly a routine measure, but rather a calculated attempt to thwart federally-approved action that was unpopular locally. *Metalclad Corporation v. Mexico*, ICSID Case No. ARB(AF)/97/1, Final Award of the Tribunal on Jurisdiction and Merits, ¶¶86–101 & 105–112 (Aug. 30, 2000).

37 Productivity Commission Report, *supra* note 2, at 271.

2007 draft model BIT. Norway has not entered into a BIT since 1995 when it signed agreements with Russia and Peru.³⁸ Norway's 2007 draft model BIT was viewed as the first step in a renewed effort to enter into more treaties. Norway abandoned its draft model BIT in 2009, however, largely because of concerns that treaties based on the model might unduly restrain regulatory activity in the public interest,³⁹ even though that draft explicitly protected Norway's "right to regulate" and its power to enact measures "it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to health, safety or environmental concerns."⁴⁰ The European Parliament has recently expressed "deep concern" that arbitrators have discretion to interpret investor-protection clauses with the effect of "ruling out . . . legitimate public regulations."⁴¹ Indeed, the demise⁴² of the Multilateral Agreement on Investment⁴² in late 1998 was based on similar fear of interference with domestic regulation.⁴³ Elements within the United States have also expressed such concerns, particularly after a 1999 NAFTA case in which a Canadian investor, Methanex, challenged

38 For a list of Norway's bilateral investment treaties, see United Nations Conference on Trade and Development, Investment Instruments Online, http://www.unctadxi.org/templates/DocSearch___779.aspx. For the date of Norway's agreement with Peru, see Organization of American States, Foreign Trade Information System, http://www.sice.oas.org/ctyindex/PER/PERBits_e.asp.

39 Damon Vis-Dunbar, *Norway shelves its draft model bilateral investment treaty*, <http://www.iisd.org/itn/2009/06/08/norway-shelves-its-proposed-model-bilateral-investment-treaty/>.

40 Norway 2007 Model BIT, art. 12, available at http://www.pca-cpa.org/showpage.asp?pag_id=1391. The Norwegian government's commentary on the draft model emphasized the importance of preserving rights to regulate in future treaties, stating that "[t]he main condition on concluding investment agreements is that the agreements shall be able to fulfill their economic and political functions without intervening unnecessarily in Norwegian exercise of authority" and "[a] prerequisite for Norway on concluding investment agreements must be that the agreements do not intervene in the state's legitimate exercise of authority where major public interests are affected." Government of Norway, Comments on the Model for Future Investment Agreements, English Translation at 13–14, 26–27 available at http://www.uio.no/studier/emner/jus/jus/JUR5850/tekster/norway_draft_model_bit_comments.pdf.

41 European Parliament Resolution of 6 April 2011 on the future European international investment policy (2011/2203(INI)), ¶¶24 and 31, Doc. No. P7_TA (2011) 0141.

42 Directorate for Financial, Fiscal and Enterprise Affairs, Organisation for Economic Co-operation and Development (OECD), *The Multilateral Agreement on Investment: The MAI Negotiating Text*, <http://www.oecd.org/daf/cmisi/mai/negtext.htm>.

43 See Karen Halverson Cross, *Converging Trends in Investment Treaty Practice*, 38 N.C. J. INT'L L. & COM. REG. 151, 179–180 (2012).

California's regulation of a water-polluting chemical.⁴⁴ (The challenge was ultimately rejected.)⁴⁵

In the United States, concern over regulatory chill has had two concrete effects: First, in 2001, the United States, Canada and Mexico entered into an agreed interpretation limiting NAFTA's "fair and equitable treatment" clause to protections afforded in customary international law⁴⁶ (an interpretation incorporated into the 2004 U.S. Model BIT);⁴⁷ second, in 2004, the United States added a provision to its Model BIT stating that routine environmental or public welfare regulations would not constitute expropriation.⁴⁸ This modification

44 Notice of Arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement Between Methanex Corporation and the United States of America, Notice of Submission of a Claim to Arbitration (3 Dec. 1999), available at <http://www.state.gov/s/l/c5818.htm>.

45 *Methanex Corp. v. United States*, UNCITRAL (NAFTA), Final Award of the Tribunal on Jurisdiction and Merits (Aug. 3, 2005).

46 NAFTA Free Trade Comm'n, Notes of Interpretation of Certain Chapter II Provisions, pt. B.2 (July 31, 2001), available at <http://www.state.gov/documents/organization/38790.pdf>. The agreed interpretation states that "[t]he concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." *Id.*

47 The 2004 U.S. Model BIT states that "[e]ach party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security." See 2004 U.S. Model BIT, *supra* note 32, at art. 5. This provision "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded covered investments." *Id.*

48 See Kenneth J. Vandavelde, U.S. INTERNATIONAL INVESTMENT AGREEMENTS 481–83 (noting that the definition of expropriation "had become an issue of some concern to the United States and other countries as a result of several arbitrations, particularly those submitted under Chapter II of NAFTA" and that the revised expropriation definition is consistent with the U.S. position in *Methanex*). Specifically, the 2004 U.S. Model BIT added a statement that, "[e]xcept in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations." 2004 U.S. Model BIT, *supra* note 32, at Annex B, P 4(b). The effects of *Methanex* and similar cases are also clear in the Bipartisan Trade Promotion Authority Act of 2002. Among the "overall trade negotiating objectives" listed in this Act is "seek[ing] provisions in trade agreements under which the parties to those agreements strive to ensure that they do not weaken or reduce the protection afforded in domestic environmental and labor laws as an encouragement to trade." 19 U.S.C. § 3802. Although this act is technically only applicable to free-trade agreements, these provisions

did to indirect expropriation what the agreed interpretation did to fair and equitable treatment in NAFTA—it modified, or at least clarified, the substantive protection provided by the treaty. Unlike Australia, however, the United States did not back away from compulsory investor-state dispute settlement in its 2004 Model BIT; nor did it back away when it again revised its Model BIT in 2012.⁴⁹ Several other countries have followed a similar approach in recent BITs, adding provisions to clarify the “fair and equitable treatment” standard⁵⁰ and to distinguish routine public welfare measures from expropriations.⁵¹

Thus, for more than a decade, many developed countries have expressed concern that investment agreements limit their ability to implement measures designed to protect the environment, health, or public welfare generally. To the extent they have tried to address these concerns in BITs it has been by modifying or clarifying the substantive obligations created by these treaties. Only Australia has chosen (at least for a while) to enter into agreements that impose the standard *substantive* obligations on states while at the same time refusing to include in any agreement the standard *procedural* means of enforcing compliance with those obligations, that is, a compulsory investor-state

indirectly affected the 2004 U.S. Model BIT due the U.S. BIT negotiators’ desire to create a comprehensive and coherent U.S. foreign investment policy.” See Vandeveld, *supra*, at 72.

49 2012 U.S. Model Bilateral Investment Treaty, *available at* <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>.

50 The NAFTA approach—defining fair and equitable treatment according to customary international law—is included in a number of recent BITs, even BITs that do not involve a NAFTA party. See United Nations Conference On Trade And Development, UNCTAD Series on Issues in International Investment Agreements II, Fair and Equitable Treatment, at 25–29 (2012) (noting that this standard is included in the ASEAN-Australia-New Zealand FTA, the Japan-Philippines FTA, the China-Peru FTA, the Malaysia-New Zealand FTA, the India-Republic of Korea Comprehensive Economic Partnership Agreement). Other countries have limited the definition of fair and equitable treatment by including additional substantive content to that standard in their recent BITs. *Id.* at 29–35.

51 Countries have accomplished this goal by (1) including a clause in the BIT explaining that non-discriminatory regulations that address public welfare objectives do not constitute expropriations except in rare circumstances; or (2) excepting from the BIT entirely government measures directed at public welfare. See United Nations Conference On Trade And Development, UNCTAD Series on Issues in International Investment Agreements II, Expropriation, at 86–90 (2012) (providing examples of each type of BIT clause). Examples of the explanatory clause approach include the Canada-Jordan BIT (2009), the Chile-United States FTA (2003), and the Belgium/Luxembourg-Columbia BIT (2009). *Id.* at 86. Examples of the exception clause approach include the India-Republic of Korea Comprehensive Economic Partnership Agreement (2009), the Canada-Jordan BIT (2009), and the Malaysia New Zealand FTA (2009). *Id.* at 89.

dispute-settlement process that may be initiated by the investor. Before concluding that Australia's recent policy was misguided, however, it might be useful to consider just what it is that has given rise to the concerns of developed states, and to do that in light of Australia's prior policy of not including ISDS provisions in its investment agreements with other developed states.

The Sources of Developed-World Discontent

Commentators have often observed that developed states entered into investment agreements with ISDS provisions for the purpose of holding developing countries—with, at best, developing respect for the rule of law—to their treaty commitments,⁵² never anticipating that their own treatment of foreign investors might be challenged in, much less be found wanting by, arbitral tribunals established under these treaties.⁵³ The fact is, however, that this expectation of developed countries very largely has been met; the ISDS provisions of investment treaties have served to hold developing countries to their commitments, and investors from developing countries have only rarely used ISDS procedures to challenge the treatment of their investments in developed countries.

If one uses membership in the Organization for Economic Co-operation and Development (OECD) in 1989 (the end of the Cold War) as an objective, if somewhat arbitrary, means of identifying countries that are today both economically and legally “developed” (that is, in which respect for the rule of law is well developed),⁵⁴ one finds that of the over 500 publicly known

52 See, e.g., Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT'L L. & POL'Y 157, 171 (2005) (noting that early “BITs were a defensive reaction to past expropriations of existing investments without payment of fair market value” and calling the inclusion of investor-state dispute settlement in BITs a “major innovation”).

53 See Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT'L L. 45, 75–79 (2013) (“When capital-exporting states originally drafted investment treaties, they viewed them as exclusively or primarily aimed at protecting the rights of their investors abroad and thus demonstrated little concern about the breadth of interpretive authority being delegated to investment tribunals or the absence of clear language protecting regulatory powers.”)

54 OECD members in 1989 were Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States. OECD, List of OECD Member Countries, <http://www.oecd.org/general/listfoecdmembercountries-ratificationoftheconventionontheoecd.htm>. The 1989 cut-off date is useful primarily as a means of excluding the many formerly communist countries that are now members of the OECD and that, at least in the eyes of foreign investors,

investor-state disputes,⁵⁵ only a handful have been brought against developed countries—the authors have identified only 53.⁵⁶ More telling, however, is the fact that, of those 53 cases, 41 were brought by investors from other developed countries, 34 of which were brought under NAFTA by Canadian investors against the United States or by U.S. investors against Canada.⁵⁷ It is not going too far to say that these 34 NAFTA cases—or at least some of them—are at the heart of the various concerns expressed by developed countries; as already noted, NAFTA cases were the only cases cited in the report of Australia's Productivity Commission. When one recalls that NAFTA's predecessor, the Canada-U.S. Free Trade Agreement, contained investment-protection provisions essentially identical with those found in NAFTA but made no provision for investor-state dispute resolution,⁵⁸ one almost unavoidably wonders whether the concerns of the developed world with respect to BITs, about which so much is written, are just an unintended consequence of NAFTA's introducing ISDS into the previously untroubled world of U.S.-Canada cross-border investment.⁵⁹

Indeed, one also might reasonably wonder whether the introduction of ISDS into the U.S.-Canada relationship was purposeful or was the almost accidental result of both countries wanting ISDS to be available to their investors in Mexico. The fact is that, even today, Canada is the only country that was a member of the OECD in 1989 with which the United States has an investment agreement that provides for investor-state dispute settlement procedures.⁶⁰ Neither France nor Germany is a party to an investment treaty with any of

have not yet achieved a rule-of-law stature comparable to that of most older members of the OECD.

- 55 See United Nations Conference on Trade and Development, *Recent Developments in Investor-State Dispute Settlement*, Annex 2 (May 2013). Lists of known arbitrations that may be sorted by respondent country (among other factors) are maintained by UNCTAD. See UNCTAD Database of Treaty-Based Investor-State Dispute Settlement (pending and concluded), <http://iiadbcases.unctad.org/>.
- 56 See UNCTAD Database of Treaty-Based Investor-State Dispute Settlement (pending and concluded), <http://iiadbcases.unctad.org/>.
- 57 *Id.*
- 58 See Canada-United States: Free-Trade Agreement, Ch. 16, Investment, U.S.-Can., Dec. 22, 1987-Jan. 2, 1989, 27 I.L.M. 281.
- 59 As one commentator has observed, while NAFTA's "novelty" was noted at the time, "its implications were not fully appreciated." William S. Dodge, *Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement*, 39 VAND. J. TRANSNAT'L L. 1, 19 (2006).
- 60 See United Nations Conference on Trade and Development, Investment Instruments Online, http://www.unctadxi.org/templates/DocSearch___779.aspx.

these countries that contains ISDS provisions, with the important exception of the Energy Charter Treaty (ECT). The UK (also a party to the ECT) has but one such treaty with a member of this group, and that is its 1961 treaty with Turkey.

One might therefore reasonably conclude that an important part of addressing the present concerns of developed countries would be for those countries to follow rather strictly Australia's prior policy of not entering into investment agreements with other developed countries that contain compulsory investor-state dispute-settlement procedures. The introduction of such procedures into the cross-border investment relationship of two countries in which the rule of law prevails and foreign investors have no substantial basis for concern that they will be treated unfairly is, simply put, asking for trouble, as is amply demonstrated by the many Canada-U.S. NAFTA cases.

This is not to say that the substantive changes that have been made to model BITs are not useful. While ISDS provisions may serve no important purpose (indeed, may be counterproductive) in treaties between countries in which respect for the rule of law is well developed, such developed countries still have very good reasons for including ISDS procedures in their investment agreements with countries in which respect for the rule of law is, at best, a work in progress. Disputes between the governments of such developing countries and foreign investors predictably will arise; without treaty-based ISDS procedures, those disputes either will not be settled at all or they will become disputes between the concerned governments. And while the actions of governments of developed countries thus far have only rarely been challenged by investors from developing treaty partners, the fact is that these developing countries increasingly are playing the role of capital exporters (China being the foremost example), and as this trend continues developed countries can expect to find themselves increasingly in the role of respondents in cases brought by investors from developing capital exporters. This predictable trend then brings one back to where this discussion started: Should other developed countries follow Australia's lead and refuse to enter into treaties with any countries, including developing countries, that contain compulsory ISDS provisions? The obvious answer would seem to be "no," because it would leave a developed state's investors in a developing country without what has become the standard remedy for mistreatment by the host state. If that answer is so obvious, however, the obvious next question is: Why did Australia's prior government not see it that way?

According to the report of the Productivity Commission, "the Commission received no feedback from Australian businesses or industry associations indicating that ISDS provisions were of much value or importance to them."⁶¹

61 Productivity Commission Report, *supra* note 2, at 270.

This, of course, begs the question: Why not? The Productivity Commission Report gives two answers to that question. First, it notes that “as far as the Commission is aware, no Australian business has made use of ISDS provisions in Australian IIAs [International Investment Agreements].”⁶² The second answer is that Australia’s larger capital exporters, which the report implies consist mainly of mining and other extractive enterprises, “may be able to negotiate specific agreements that contain dispute resolution mechanisms with foreign governments, prior to undertaking any investment. . . .”⁶³ A third answer, not contained in the Commission’s report but often offered by others, is that Australian companies can structure almost any foreign investment through a subsidiary incorporated in a country that has a full-service investment treaty with the host-state.⁶⁴

The first two reasons described above would indicate that Australia’s situation is unusual, if not unique, among developed capital-exporting states because, were Australia’s situation typical, it would be difficult to explain the popularity of ISDS provisions in investment agreements. Indeed, given the objections to ISDS that now commonly arise in developed countries, it would be somewhat remarkable if a developed country continued to include ISDS provisions in its BITs absent strong business support.⁶⁵ Australia’s situation being at least unusual, Australia’s resulting policy of rejecting ISDS provisions in *all* investment agreements cannot be viewed as much of a precedent for other developed capital-exporting states, particularly those with many investors that are not in a position to negotiate investment-specific agreements with host states. As for the third reason offered above, to the extent Australian

62 *Id.*

63 *Id.* and n. 4.

64 For example, the Investment Arbitration Reporter reported at the time that “One Australian practitioner, Michael Polkinghorne of the law firm White & Case, tells IA Reporter that investors may have the ability to work-around the absence of arbitration clauses in Australian agreements by free-riding on the treaties concluded by other countries.” Luke Eric Peterson, *In Policy Switch, Australia Disavows Need for Investor-State Arbitration Provisions in Trade and Investment Agreements*, Investment Arb. Rep., Apr. 14, 2011, <http://www.com/articles/20110414>. Quoting Mr. Polkinghorne, the report continues: “It certainly creates a concern for Australian investors seeking to invest abroad, although frequently these concerns can be addressed by intelligent corporate structuring. The real problems may well be for those investors who never think about treaty rights in the first place.” *Id.*

65 Governments have their own reasons for supporting ISDS provisions that are unrelated to the views of business, for it is those provisions that prevent a dispute between a foreign investor and a host state from becoming a state-to-state dispute.

investors expect to be free riders on third-country BITs, one can only wonder how much this will encourage restrictive notions of corporate nationality in future BITs.

III *The Future of BITs and ISDS*

The objections of Venezuela, Bolivia, and Ecuador cannot be addressed in the current BIT and ISDS regime because those objections go to the obligation imposed by all BITs to compensate investors when the state takes their property. There is no way for a country to address this objection short of withdrawing from its investment treaties, as these countries have done or are doing.

Situations such as those faced by Argentina and Indonesia over the last 15 years are best addressed by these countries' refusing to make imprudent promises to foreign investors. In addition, changes at the margin of the BIT regime—such as the U.S. change to the non-precluded measures provision in the 2004 Model BIT—may help to address the concerns raised by the Asian and Argentine financial crises.⁶⁶

Addressing the objections of developed countries is more complicated. Perhaps these objections can adequately be addressed by means of modest alterations in the substantive language of investment treaties of the sort that have found their way into the United States' 2004 Model BIT, which strengthened the host nation's ability to enact nondiscriminatory environmental, labor, and other public-welfare regulations. But developed states also should consider, case-by-case, whether the inclusion of compulsory investor-state dispute-resolution procedures in an investment agreement in fact will serve a useful purpose. And when the agreement is between or among countries in which the rule of law prevails, perhaps those states should consider the experience of the United States and Canada under NAFTA and the political resistance to BITs in general that has been generated by Canada-US investment cases. "If it ain't broke don't fix it" often is very good advice.

66 The 2004 U.S. Model BIT added provisions clarifying that a state itself may judge whether non-precluded measures are warranted. See 2004 U.S. Model BIT, *supra* note 32, at art. 18(2); Cross, *supra* note 9, at 196–97.